

## INSIGHT

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### Oracle Announces It's Acquiring Sun Microsystems

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## IDC OPINION

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Oracle's announced acquisition of Sun Microsystems brings closure to a difficult seven years for Sun, which continued to be a technology innovator in systems and software, but had difficulty regaining sustained profitability following the dot.com bust of 2001-2002. Sun was having a rough time in the current recession, with fewer "big deals" and many low-margin deals for hardware and support services. Importantly, Sun had difficulty monetizing the investments it had made over the years in its key differentiators—Java, Solaris and OpenSolaris. It also struggled to sustain significant momentum in the storage sector following its 2005 acquisition of StorageTek.

On April 20, 2009, Oracle and Sun announced that they have entered into a definitive agreement through which Oracle would acquire Sun common stock for \$9.50 per share in cash. The transaction is valued at about \$7.4 billion, or \$5.6 billion net of Sun's cash and debt. The deal, which would need to be approved by Sun stockholders and by federal regulators, is expected to close by summer, 2009. Sun's business has a run-rate of more than \$13 billion annual revenue, and Oracle has an annual run-rate of about \$22 billion.

This deal was made in Silicon Valley, based on the longtime relationships not only between Oracle and Sun, but also between Oracle CEO Larry Ellison and Sun chairman Scott McNealy. It is likely that this is just a first step, and once the deal closes there will be a series of additional steps about which businesses to keep as standalone units, and which to combine with existing offerings. Certainly, Oracle has put forward the idea that holistic server-based solutions would be extremely useful to customers, combining a technology stack of standalone products—hardware, operating system, database, middleware, and applications—all of which the combined Oracle and Sun could offer.

Given its weeks of negotiations to buy Sun for a similar price—which was reported to be nearly \$7 billion, or between \$9 to \$10 per share of Sun—IBM is very likely to be extremely frustrated with this deal. This is particularly true on the Java front because now Oracle will control the destiny of Java—and IBM will not—and because Java is an important leverage point for Internet computing, which underlies much of IBM's middleware stack (e.g. IBM WebSphere, IBM Domino). IBM may have become convinced that Sun simply didn't have any other options when IBM-Sun talks broke off in early April. However, the geometry of Silicon Valley relationships, which have brought the computer industry adaptability for many decades, seem to have surfaced in this deal.

In many ways, the current economic downturn is bringing about this IT industry inflection point, as vendors prepare for the next wave. The deal comes at a time of industry transformation, where technology convergence (servers, storage, software, networking connections, and services) is re-making the enterprise data center—and changing the way service providers deliver business value to their end-customers, either directly, or through cloud computing. Oracle said that it is considering building end-to-end technology stacks, leveraging Sun's servers, storage, and software, along with Oracle's database, middleware, and applications software—but it is too early in the acquisition process to predict what form this will take.

The biggest question will be the ultimate status and positioning of Sun's various hardware businesses—servers, storage, and tape. Although not an immediate problem, with respect to government approval of the deal, ultimately the combined company would have to rationalize the hardware business. Possible moves include spinning off the tape business as a separate business unit and figuring out how to market Sun's server and storage products, possibly as part of integrated solutions. These server and storage businesses compete directly with those of HP and other server OEMs—all of which partner with Oracle for database, middleware, and application software. Further, Oracle is already partnering with HP to deliver an all-in-one data warehouse solution, called Oracle Exadata, built on HP ProLiant x86 servers and the Oracle Database.

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## **Key Take-Aways from the Deal**

Key take-aways from the Oracle acquisition of Sun include the following:

- ☒ Oracle is looking to ensure the survival of Java and its open-source development technologies. Further, as a strategic matter, this acquisition assures that neither IBM nor Microsoft would acquire and control future development of Java. Since Oracle is highly dependent on the continued relevance of Java, moving into the role of custodian gives it an added measure of control. However, in this new role Oracle will need to communicate and demonstrate to the Java community that its democratic roots will be preserved and that the Java Community Process (JCP) will be improved, with more input from committee members.
- ☒ The deal places Java in a company that values it for the ability to run applications on any platform, which is especially important in enterprise computing. Oracle's interest would be to continue the Java franchise—and to foster the Java community worldwide—and IDC expects that Oracle will do whatever it takes to maintain the momentum of Java, both for the enterprise, and for the Java-enabled Internet handset and cell business smart clients.
- ☒ Next-generation datacenter deployments will require side-by-side deployments of multiple operating systems on virtualized x86 server infrastructure. Oracle has always been focused on cross-enterprise deployments on platforms running a variety of operating systems (e.g. Linux, Unix, Microsoft Windows, IBM z/OS, and others). In a virtualized datacenter, having Solaris and OpenSolaris (a form of

Unix) and Linux running side by side, will not be problematic and can be viewed by Oracle as a definite plus as well as a counterweight to Microsoft.

- ☒ Oracle's business application stack, Oracle Fusion middleware, and Oracle Database products (including Oracle RAC) already run on all of Sun's software platforms, so no change in operating systems support will be needed following acquisition. Oracle's strong push behind Linux, via its leverage of Red Hat Linux software as the basis for Oracle Virtual Machines (OVM) hypervisor, and as a preferred platform for Oracle Real Application Clusters (RAC), would need to accommodate a nuanced positioning, where Solaris and Linux would be seen as two important operating environments for next-generation enterprise data centers.
  
- ☒ IDC notes that Sun has interesting software assets across the software landscape: in infrastructure (e.g. the ZFS file system for storage, GlassFish for developers and software appliances); database (MySQL), and development tools (NetBeans). MySQL could be viewed as an additive product, bringing customers who deployed both MySQL and Oracle databases—and those who have not deployed Oracle. However, there is some overlap in the middleware space, and IDC believes Oracle will carefully evaluate which products should go forward, and which should converge, over time, with Oracle middleware products.

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## CONCLUSION

Oracle said it will run Sun as a profitable business unit, implying that there will be organization and operational changes. In this sense, the merger could be viewed as the end of an era—when a 1982 start-up, Sun Microsystems, grew to an improbably large \$20 billion run-rate during the Internet boom and Y2K preparations of 1999-2000. Following the dot.com bust of 2001, Sun never regained that level of business and profitability. Ultimately, Sun was forced by economic conditions, and tightening IT budgets, to seek a buy-out, because the sale opportunities and the company itself were shrinking. If the deal is approved, Oracle would capture the large Sun installed base, estimated to be at least 1.6 million actively used servers worldwide (including RISC servers and x86 servers). IDC believes that Oracle is in a position to leverage much of Sun's intellectual property (IP). What's not clear is the fate of specific Sun products, including the M-Series systems, that are manufactured by Fujitsu Ltd., and SPARC CMT-based systems, such as the Niagara rack-optimized and blade systems.

This deal to some extent redraws the lines of competition in the IT space. For many years, there was a comfortable *detente* between the creators of value at the Hardware, Operating System, Database, Middleware, and Application levels. While there were occasional border wars and alliances, there was generally peace—or at least clear segmentation between those businesses. Now, in a time of technology convergence, the rules are changing. We have already seen that with recent announcements from Cisco, HP, IBM, Dell, and others. With the stroke of a pen, the combination of Oracle and Sun can deliver chips to applications, and everything in between, but the exact shape of this combined technology offering is yet to be determined. While this structure may not stay in place, as is, it will usher in a different basis for competition, one where customers are offered far more integrated platforms,

and service providers deliver all-in-one Internet-enabled services, directly, and via the cloud, and where competition between past partners is far more common.

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